"It was worth it"

Sanja and Christian Nikolac live with their two children, Kelli and Paola, in Lovranska Draga, Croatia. This is one of the most scenic parts of the Dalmatian coast, very near to the cities of Opatija and Rijeka. The region has historically attracted tourists. In the days of the Habsburg empire, the town was a sophisticated tourist destination thanks to its proximity to Austria and Italy. The Nikolac family wanted to revive those good old days by restoring the Hotel Draga di Lovrana to its original splendour after the building had been run-down for years. In the late 19th century, this fine hotel welcomed the Austrian Emperor Franz Josef, who would enjoy the spectacular view. Today, with Croatia's growing ties to the European Union and the region's easy access from Italy, a new tourist boom is expected. Many historic hotels and villas have been restored in recent years, and are in prime condition to welcome visitors.

Erste Bank: "Mr Nikolac, how did you come up with the idea of restoring the Hotel Draga di Lovrana?"
Christian Nikolac: "Well, this spot is so unique and this view so spectacular, that I could not imagine a better place for an exclusive hotel with first-class dining. Clearly some people might think we're crazy, but tell us, don't you think it's worth it?"
Erste Bank: "This must have been an adventure for you! After all, you were not already in the hotel business."
Christian Nikolac: "That is true, I am in the fishing business. First, I wanted to have a base on land. Second, it has long been my dream to rebuild this historic building. We believe in the future of first-class tourism in our region. Even now, we yet have many Italian guests who appreciate high quality and are prepared to pay accordingly. Many of them are boat owners!"
Sanja Nikolac: "And we are also expecting more visitors from Austria and Germany! Thanks to my hotel management training in the United States, we are not coming into this project without any experience. For an investment on this scale, you must have the necessary expertise!"
Erste Bank: "In rebuilding the hotel, you paid close attention to remaining true to the original design. How did you achieve that?"
Sanja Nikolac: "Precisely. Every window, every door and all the other woodwork was custom built according to the original blueprints. Fortunately, they were still available! All the decorative glasswork and lamps were hand-made in Italy. These measures were necessary to preserve the character of this beautiful building!"
Christian Nikolac: "We certainly could have invested one-third less and still had a nice hotel, but it would not have been true to its origins! We have a good concept based on a premium product! In the first stage, we built the hotel and restaurant. In the second stage, we would like to build an extension in order to increase the overnight capacity."
Sanja Nikolac: "We would like for our guests to feel at home here! They should be able to enjoy this beautiful countryside and eat our fresh fish in a peaceful setting. We are working to that end as a team!"
Erste Bank: "Mr and Mrs Nikolac, we wish you all the best in the future!"

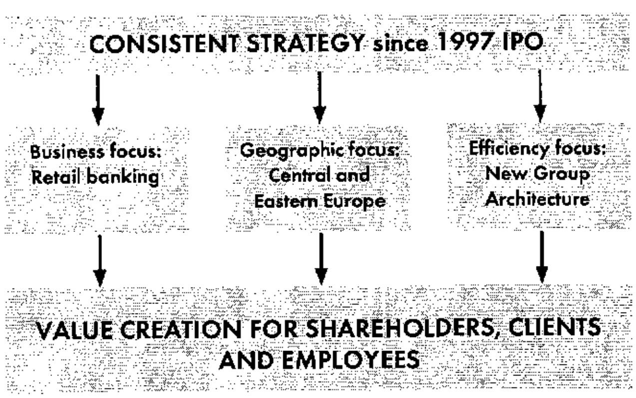
Nikolac family, clients of Erste Bank Croatia, Croatia

Strategy

Focused growth in Central and Eastern Europe
We have followed a consistent growth strategy since our initial public offering in 1997. This strategic commitment has led to substantial value creation for shareholders, clients and employees alike. At the time Erste Bank formulated four core strategies:

1. Focus on core business potentials in retail banking
2. Build a strong brand with the Austrian savings banks
3. Target a home market of 40 million people in Central Europe
4. Transfer the multi-channel distribution model throughout Central Europe

Following successful implementation and building on the key strengths, we have fine-tuned our core strategies to reflect the evolution of Erste Bank and its goals as well as changes in the operating environment. The result is a set of three main strategic pillars that define Erste Bank's historic and future business success, as outlined below:



The **business focus** pillar unites our former retail and multi-channel strategies, in line with today's reality that electronic distribution channels form an integral part of any successful retail banking strategy. Otherwise our focus on **retail banking** remains unchanged. The same is true for our **geographic focus**: it now reflects our broader regional coverage and integrates our Austrian strategy to work more closely with the savings banks sector. Our third strategic pillar, while seemingly new, has also strong roots in our former retail banking strategy, which was very much centred on better exploitation of our core business potentials. The New Group Architecture programme carries on this **efficiency focus** on a group-wide basis. The following paragraphs describe our three main strategic pillars in more detail.

Business focus: retail banking
A clearly defined business focus lies at the core of Erste Bank's operations: we directly serve 15.2 million retail clients in seven countries and operate some 2,700 branches, as well as state-of-the-art alternative distribution channels, such as internet and phone banking. Hence, while we do have substantial operations outside retail banking, retail banking is our core competence.

In a way, retail banking is also woven into Erste Bank's genetic fabric. In 1819 wealthy Viennese citizens donated funds in order to establish Erste Bank's predecessor, a savings bank. They aimed to bring affordable banking services to wide sections of the population. This goal is just as valid today as it was some 190 years ago, especially against the backdrop of operating in Central and Eastern Europe.

In today's context, retail banking is attractive for us because it offers a compelling business case, comprehensive scope in terms of product offering and the opportunity to operate in well diversified markets.

The business case is characterised by a number of favourable parameters, one of which is the lower level of volatility than experienced in corporate or investment banking. Consequently, our earnings growth is strong and stable, our provisioning levels are almost unchanged over a number of years and our capital requirements are lower. Another positive factor is the longevity of our growth path, which is a result of operating in a portfolio of markets that are at different stages of economic development.

Austria is a mature and stable banking market, the Czech Republic, Hungary, Slovakia and Croatia are developing transformation economies, while Romania and Serbia are emerging banking markets. This means that we can draw on our broad product knowledge in mature markets and selectively apply those retail banking products in lesser developed markets that are most suited to our clients' needs.

Geographic focus: Central and Eastern Europe

In the late 1990-ies we came to the conclusion that our long-term future as an independent bank was very much contingent on finding new markets outside Austria: at that time growth opportunities were limited, leaving only repeated cost cutting exercises as a way to improve the bottom line. As a result we decided to make a long term commitment to the markets at our doorstep, essentially our neighbouring countries in Central Europe – the Czech Republic, Slovakia, Hungary, Croatia and Slovenia. We defined an extended home market of 40 million people with the clear intention to enter these markets by making selected acquisitions. In Austria we pursued a policy of seeking closer integration with the savings banks sector in order to increase scale, offer our clients better value and work more efficiently.

Since then we have far surpassed our initial goals. Our home market now covers a contiguous region of nearly 70 million inhabitants, we have successfully integrated more than ten acquisitions in Central and Eastern Europe, and in Austria we have made a quantum leap forward in our efforts to work more closely with the savings banks through the establishment of the cross guarantee system. This agreement forms the basis for a wide-ranging cooperation between Erste Bank and the savings banks covering such aspects as common back office structures, common marketing and common product development.

Our expansion into Central and Eastern Europe has yielded great benefits: shareholders have enjoyed sustainable earnings growth, customers can access our comprehensive range of services in more countries than ever before, and our employees have more development opportunities than at any time in the company's history. Consequently, we will continue on our proven growth path, extending our footprint in Central and Eastern Europe, when suitable opportunities arise.

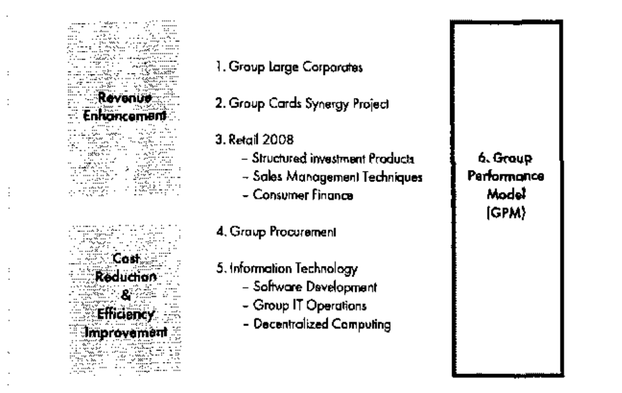
Efficiency focus: New Group Architecture

The New Group Architecture (NGA) programme lies at the heart of our ambition to work more efficiently across the group and is a direct result of our expansion as well as the realisation that a number of tasks are more efficiently carried out on a group-wide, standardised basis, while sales and marketing efforts are best handled locally. Or put differently, the New Group Architecture aims to create a more successful banking group of what is already a successful group of banks.

Launched in mid-2004, the NGA programme will translate into revenue enhancements, cost reductions and efficiency improvements. Accordingly, we grouped the six major programme streams along these lines, as shown below: the Group Large Corporates project, the Group Cards Synergy Project and the Retail 2008 project are designed to deliver revenue enhancements, while the Group Procurement project and the Information Technology project will be sources of cost reductions and higher work efficiency. The Group Performance Model will deliver the transparency needed to effectively steer the group.

The Group Performance Model (GPM) acts as the strategic backbone of the NGA programme. It standardises definitions and processes, aiming to make all our operating units comparable. More specifically the GPM creates uniform standards for the recognition and allocation of costs and revenues and organises major performance indicators and controlling tools for benchmarking purposes, in order to facilitate identification of additional savings potentials and revenue synergies.

NGA aims to create synergies across the group



Source: Erste Bank.

A unified, group-wide approach towards our large corporate customers is behind the establishment of the Group Large Corporates business unit. Through better integration of treasury, capital markets and other investment banking activities we aim to be the partner of choice for all the financing needs of our large corporate customers. The target group consists of some 650 companies with annual revenues of more than EUR 175 million each, which operate in one or more of our markets. In 2005 we had a business relationship with approximately 200 of these entities.

The Group Cards Synergy Project concerns the payment card business. The card business is broadly defined to include debit cards, credit cards, and the installation of additional POS systems and ATMs. Erste Bank's goal in the card business is to be the leading provider of debit and credit cards as measured by both number of cards and usage. As part of the Group Cards Synergy Project, a new group-wide card responsibility is being set up. This responsibility is designed to achieve a coordinated market approach through a common card business plan, a card loyalty programme, intensified merchant acquisition, uniform card credit risk management as well as harmonisation of group-wide card processing.

"Retail 2008" represents a package of knowledge sharing initiatives under a single umbrella. "Retail 2008" aims to spread best practices in retail banking across our group. The programme involves developing business and product initiatives – for example, in the area of structured investment products and an enterprise-wide consumer finance strategy complementary to the traditional retail business. These projects are intended partly to address existing clients and partly to target new customer groups and additional medium term revenue potentials.

The main objectives of the Group Procurement project comprise group-wide pooling of information on non-staff administrative expenses and investment, bundling of procurement volumes, identifying potential savings achievable through improved demand management and standardised specifications, and creating a single procurement organisation with uniform procurement processes.

The Information Technology project is expected to yield substantial cost reductions, but also efficiency improvements. It will focus, amongst other elements, on streamlined demand management, a uniform IT master plan, the bundling of software development functions as well as operating units and will unify desktop and decentralised equipment management.

We have already achieved a number of quick wins: we have established a group-wide software development unit and have formed a separate procurement organisation that is well on track in realising substantial savings. The new business unit Group Large Corporates is fully operational since mid 2005 and has already shown favourable operating result development. Structured investment products, which were rolled-out in all countries of our extended home market in 2005, are also performing well. Accordingly, we are confident to achieve the concrete financial target – a positive pre-tax contribution of EUR 210 million annually as of 2008 – set out at the Capital Markets Day 2005.

GROWTH DRIVERS

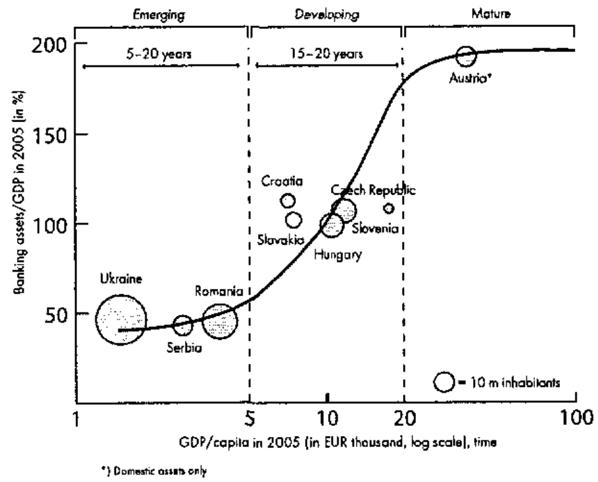
Our investors routinely ask us where future growth will come from. Since growth is not only an essential part of our equity story, but also of strategic importance to our business model we will briefly present long-term development patterns in our markets, as well as the three most important determinants of future growth: loan growth, wealth management and regional expansion.

GROWTH PATTERNS

Our business model benefits from a unique growth profile that extends over the next 20 - 30 years and is tied to the economic catch-up process of Central and Eastern Europe. It derives its strength from the fact that our markets are at different stages of development. For this purpose we have classified our markets into three clusters: emerging, developing and mature markets, as shown in the chart overleaf.

Emerging markets are characterised by a GDP/capita level of below EUR 5,000 and a banking asset penetration of some 50% or less. Depending on the economic position at the start of transformation, we estimate this period to take between

Banking development in transformation economies

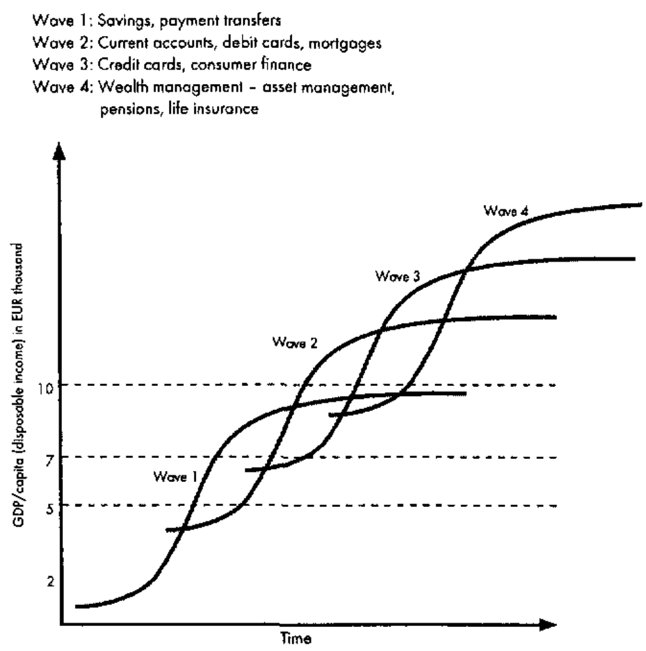


Source: Local central banks, Eurostat, Erste Bank.

5 – 20 years. Within our business portfolio Erste Bank Serbia and Banca Comerciala Romana, our Serbian and Romanian subsidiaries respectively, operate in such markets. At this stage of development growth is mostly derived from plain-vanilla banking products, such as savings, payments transfers as well as current accounts and debit cards, which are represented by waves 1 and 2 in the right-hand exhibit. While household loans usually play an insignificant role at these levels of income, an increase in the banked population is typically a major source of growth.

Developing markets feature GDP/capita between EUR 5,000 and EUR 20,000 and a banking asset penetration ratio of anywhere between 60% and 140%. We estimate that this stage lasts at least 15 – 20 years. In this period retail lending comes off age and transformation countries reach a level of wealth that facilitates the introduction of more sophisticated banking products, such as mortgages, credit cards, consumer loans as well as wealth management products, represented by growth waves 3 and 4 in the right-hand chart. Our central European businesses in the Czech Republic, Slovakia, Hungary and Croatia fall into this bracket.

Banking growth paths in transformation economies



Source: Erste Bank illustration.

Mature markets are defined by GDP/capita in excess of EUR 20,000 and banking asset penetration north of 150%. These tend to offer only selected growth opportunities and typically only grow in line with GDP. We find it useful to operate in such markets to the extent that we can draw on experiences and transfer knowledge to less developed markets. Depending on the factors that influence market structure, the most significant of which is shareholder orientation or the lack thereof, these markets can either be very profitable such as in the UK or Spain, or less so, such as in Austria or Germany.

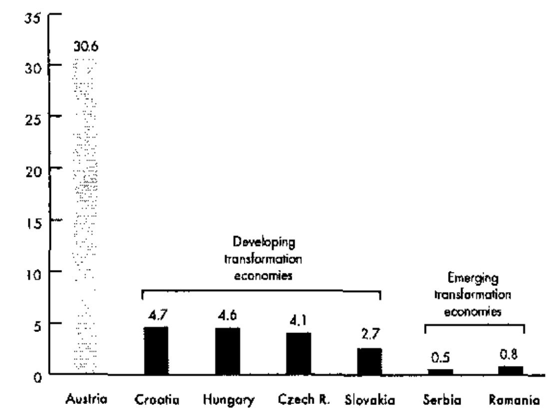
LOAN GROWTH

In many countries we operate in retail lending was non-existent just a couple of years ago, firstly because nominal and real interest rates were high, secondly because disposable incomes did not support household credit growth and thirdly because of a lack of a healthy competitive environment due to high levels of state ownership. All this has changed over the last years: in developing transformation economies interest rates are in the process of convergence or have already converged, disposable incomes have risen strongly on the back of overall GDP growth, and most state banks have been sold to foreign strategic investors fostering product innovation and competition. This powerful combination underlies current growth trends and will fuel future growth.

To assess the maturity and hence the credit growth potential of banking markets such loan penetration measures, as customer loans/GDP, household loans/GDP and/or mortgages/GDP are commonly used. For countries with highly diverging levels of GDP/capita, though, this masks the true growth opportunity, as it discounts the impact of GDP growth itself. For instance, the assumption that developing transformation economies with customer loan penetrations of between 40% to 60% are already fairly developed and hence offer limited incremental growth opportunities compared to mature economies such as Austria, where domestic loan penetration is somewhat above 100%, are not factoring in that it is the GDP growth differential that is the major driving force behind the loan growth opportunity. As a result, we believe that absolute per capita figures offer a fairer reflection of the growth opportunity than relative measures.

The following chart shows the enormous gap that even today exists between mature and developing economies on the one hand and between developing and emerging economies on the other. Countries, such as Hungary and the Czech Republic, but also Croatia and Slovakia are many years away from reaching Austrian, let alone west European levels of loans per capita. This picture is even starker with the countries we entered in 2005: Romania's and Serbia's levels of private sector indebtedness are barely registering on the radar screen in the context of developed economies. Hence, we believe that credit expansion will be a secular growth trend, rather than a process that has already surpassed its peak.

Customer loans/capita in CEE (2005) in EUR thousand



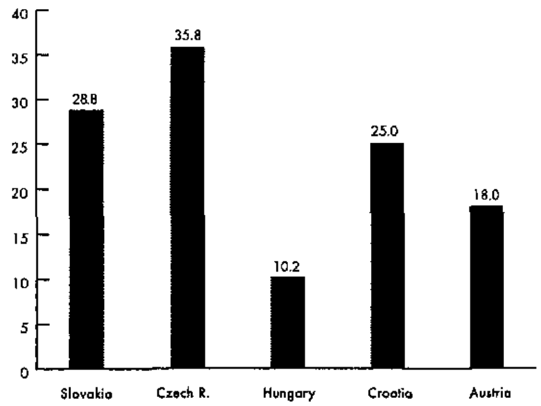
Source: Local central banks, Eurostat.

Within the overall loan growth trend, we will particularly benefit from our exposure to the retail customer. Retail lending, particularly in the form of residential mortgages, has only just started in almost all our markets. A point in case is mortgage penetration: it equals about 10% of GDP in our most developed markets, while it is yet substantially lower in Romania or Serbia. Even in Austria this measure only stands at 22%, leaving room for growth, while in the European Union it has reached an estimated 46% in 2005.

WEALTH MANAGEMENT

While private sector and especially retail credit expansion will be the growth engine of the immediate future, wealth management, which covers our private banking, fund management and life insurance business lines, will drive growth as our markets become wealthier. Irrespective of when this actually happens, we are already uniquely positioned to benefit from any such development: we dominate the fund management markets in our existing central and east European universe with a market share of 24.3% and we can draw on our experience in Austria, where we are leaders in retail funds and hold the No. 2 spot

Erste Bank fund management market shares (2005) in %



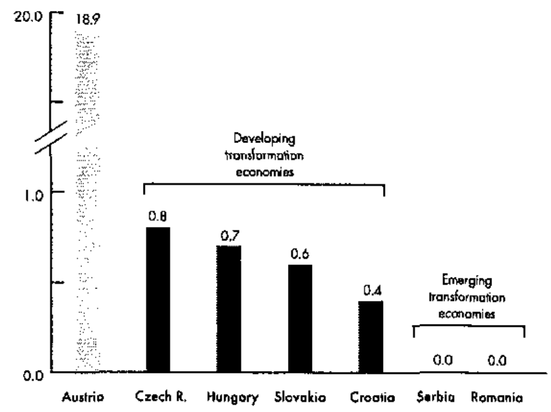
Source: Erste Sparinvest.

overall with a market share of 18%, as detailed above. In life insurance, we lead the market in Austria, while we have established strong footholds in all other markets.

As pointed out, the growth dynamics in fund management differ fundamentally from those experienced in standard banking products, in so far as meaningful growth typically kicks in at a later stage of economic development. Based on historic trends in countries such as Spain or Austria, we estimate that growth in fund management reaches critical mass when nominal GDP/capita hits the trigger point of about EUR 10,000. Many of our central and east European markets are quickly approaching this threshold. It is at this level that we believe basic consumption needs are satisfied and attention starts to shift to providing for the future.

Accordingly, the divide in fund management between mature and developing markets on the one hand, and between developing and emerging transformation economies on the other is even starker than that experienced in the area of loans. As shown in the right-hand exhibit, funds under management per capita in Austria equalled EUR 18,900 at the end of 2005, while the same figure stood at about EUR 700 and EUR 800 in Hungary and the Czech Republic, respectively. In Romania fund management was in the process of regaining credibility after a number of fraud cases at the turn of the century. While funds under management per capita were higher a couple of years ago than the EUR 4 registered at the end of 2005, either figure pales into insignificance compared to more developed markets. At the end of 2005 Serbia still lacked the legal infrastructure for fund management and accordingly all the growth is still ahead.

Funds under management/capita in CEE (2005) in EUR thousand



Source: Local fund management associations, Eurostat.

While growth in fund management follows a more cyclical pattern, life insurance growth is steadier and tied to state regulations on pensions and savings as well as tax breaks. Demographic trends, such as the ageing of society, and the increasing requirement for private old age provision also play a significant role in determining demand for wealth management products in general and life insurance policies in particular.

REGIONAL EXPANSION

Regional expansion was a major growth driver in the past and will continue to be a significant source of growth in the future. In this context, acquisitions play a major role in our business model. So far acquisitions were the preferred way by which we executed our central and east European expansion strategy. Since 1997 we have bought ten banks and invested about EUR 6.5 billion into Central and Eastern Europe, thereby actively contributing to the regeneration and redevelopment of the region.

When we buy a bank we adhere to a defined set of guiding principles. Firstly, we always aim to buy a bank with a leading market position or when this is not feasible an operation that we feel has a chance of reaching a market share of 15 – 20 % in terms of clients and/or retail products, either through bolt-on acquisitions or organic growth. Secondly, any new bank has to fit the existing network and be beneficial to our clients. Thirdly, we stick to the following financial acquisition criteria:

_A return on equity of at least 20% by the third year following the year of closing of the acquisition. Historically we have always achieved this target.
_A return on investment of 10% by the third year following the year of closing of the acquisition. This measure is important to us because it includes the impact of goodwill. Historically we have achieved ROI figures in the range of 12% – 15%.
_Achievement of earnings accretion by the third year following the year of closing of the acquisition.

What really sets our acquisition policy apart is our post deal integration expertise. The restructuring and integration process typically starts after the day of signing. A service agreement gives Erste Bank experts immediate access, so that they can familiarise themselves with day-to-day operations of the bank right away. Following closing of the transaction, a tried and tested transformation programme is put in place and executed by a multinational transformation team, led by a senior Erste Bank executive. It typically lasts no longer than 18 months and covers all material aspects of the business. In sensitive areas, such as risk management, existing staff are immediately assisted by Erste Bank staff in order to upgrade the function to group standards as quickly as feasible.

As a result of our highly developed regional expertise and our positive acquisition track record, we will continue to grow our regional franchise both through carefully selected acquisitions that fit the existing network, and organically.

Corporate Governance

In the interest of accountable management, Erste Bank is committed to implementing the Austrian Code of Corporate Governance. To ensure the greatest possible transparency for all stakeholder groups, Erste Bank adheres to all statutory rules and recommendations of this Code. Good corporate governance is regarded as a key element of Erste Bank's corporate culture.

The Austrian Code of Corporate Governance

In October 2002 the Austrian Working Group for Corporate Governance presented the Austrian Code of Corporate Governance. The Code constitutes a voluntary, self-regulatory initiative and goes beyond a corporation's statutory responsibilities. The Code seeks to promote accountable corporate management and supervision to create value in a sustainable way, and to balance and define the rights and responsibilities of every stakeholder – management, supervisory board, employees, shareholders, customers and the general public – and the relationships between these groups. The Code is designed to ensure a high degree of transparency for all stakeholders. The complete wording of the Code is available at www.corporate-governance.at.

Erste Bank is committed to good corporate governance

Erste Bank complies with all statutory rules and recommendations of the Austrian Code of Corporate Governance. Detailed explanations of the compliance with specific provisions of the Code are provided on the web site of Erste Bank at www.erste-bank.com/ir.

At the public offerings in 1997 and 2000, Erste Bank's employees had the opportunity to acquire shares in Erste Bank on preferential terms and thus benefit from the Group's upside potential in the stock market. In 2002, in addition to a management share option plan, a new employee share ownership programme (ESOP) under the name "Creating Value" was launched for all Group staff. The strong demand from staff has reinforced management's intention to continue the ESOP, with the medium-term goal of raising employees' ownership in Erste Bank from the current level of slightly less than 2% to approximately 5%.

The inclusion of employees forms an important part of Erste Bank's corporate culture. This is manifested in the regularly implemented, large-scale staff surveys whose results are analysed by external consultants and taken into account by management during decision-making process. The latest such poll was conducted in the first half of 2003. Similar surveys are carried out at subsidiaries in Central Europe. A new employee survey is planned for the first half of 2007 that will cover the entire Erste Bank Group for the first time.

The high esteem in which Erste Bank holds its employees is expressed in the Staff Charter signed at the beginning of 2004. The Staff Charter documents the employee-friendly value system as well as the aims of management and staff. In addition, in order to keep pace with the changing market environment, the Charter aims to create a focus on joint productivity at Erste Bank.

Safeguarding the rights of all shareholders is the cardinal rule of corporate management. Erste Bank thus created a clear capital structure consisting only of ordinary shares. The management embraces a retail strategy not only in the banking business, but also by encouraging retail investors to become shareholders. With this in mind, Erste Bank shares were made more accessible and marketable last year through a 4-to-1 stock split.

Shareholders' desire to speak directly with top management is accommodated by internet chats that have been held regularly since 2000. These events allow investors to find out first-hand about current developments at Erste Bank.

The rights and responsibilities of employees and appropriate conduct towards customers (Code of Conduct) are specified in a detailed and comprehensive set of instructions. The current version of these standards, which are binding for all employees, is posted on Erste Bank's intranet.

In 2005, Erste Bank voluntarily subjected its compliance with the regulations of the Austrian Code of Corporate Governance to an independent review. The findings of this review are available on the web site.

The Austrian Working Group for Corporate Governance amended the Code of Corporate Governance in 2005, adopting the core of the EU recommendations with regard to the Supervisory Board's duties and management compensation and making the necessary adjustments to reflect the 2005 Company Law Amendment Act. This amended version of the Austrian Code of Corporate Governance applies to financial years beginning 1 January 2006.

"I think of the children's future"

Klara Novak and her two children, Klara Eva and Imre, live in a nice, large historic building in Budapest. Not long ago, Klara Novak took advantage of the opportunity to work abroad for several years before entering her parents' restaurant business. Today, she is one reason Hungary is among the most prosperous and fastest growing economies of the former Eastern Bloc. With a per capita GDP of EUR 8,700 and a 7.0% unemployment rate, Hungary is among the most successful of the new European Union members. In Budapest, which has been restored to its former splendour in many areas following several years of costly renovations, Novak works as a software consultant.

Erste Bank: "Ms Novak, you worked for a few years outside of Hungary?"
Klara Novak: "Yes, it was a strenuous and often difficult time. But I learned a lot. The nearly two years that I spent in Leipzig not only prepared me to work in my parents' restaurant, but also provided me with a lot of experience."
Erste Bank: "First you worked in the family restaurant, now you are in a totally different field. How did that happen?"
Klara Novak: "Simple. My father retired, and we sold the business. I am very happy in my current job as a software consultant. Currently, I instruct and train civil servants, who are learning to work with new, specialised software. In Hungary, there is tremendous demand for software consulting. That is how I entered this field. And it pays well!"
Erste Bank: "You are also the mother of two children. How do you manage these dual roles?"
Klara Novak: "Well, I am not the only woman in this position. In my current work, I am constantly meeting women who have to deal with this situation. But naturally it can be demanding. The children themselves are a great help to me."
Klara Eva: "We are at school in the afternoons, too. We do our homework there, and our mother can be sure that we are not getting into trouble. For me at least ..."
Imre: "For me, too! And our grandfather Lajos is often home with us."
Klara Novak: "As a working woman, naturally I have little free time. But I spend every free minute with the children. In the summer, we often spend weekends at our cottage in the country."
Erste Bank: "Have you been able to put aside any of the money you have earned?"
Klara Novak: "I save a portion of my salary and invest it in a structured savings plan at Erste Bank Hungary. The sale of the parent's business also provided some income. We will be able to afford something with that later, since it is mainly for the children's education."
Erste Bank: "Thank you very much for speaking with us and for your hospitality. We are pleased to have kind clients such as yourself, and we wish you well in the future."

Novak family, clients of Erste Bank Hungary, Hungary